20 September 2023 Corporates

Greenergy Holding Vagyonkezelő Zrt Hungary, Utilities

Key metrics

			Scope estimates	
Scope credit ratios	**2021**	**2022**	**2023E**	**2024E**
Scope-adjusted EBITDA/interest cover	26x	53x	78x	39x
Scope-adjusted debt/EBITDA	3.0x	1.1x	1.3x	1.1x
Scope-adjusted free operating cash flow/debt	23%	-24%	21%	-6%
Liquidity	>200%	>200%	>200%	>200%

Rating rationale

The issuer rating is supported by the company's consistent improvement of its financial setup as reflected by low leverage, very strong debt protection and our view that future capex can largely be funded through operating cash flow. The issuer rating remains constrained by higher business risks as mirrored by the company's limited scale, high dependence on external market developments and merchant risks, primarily related to energy price movements, and the limited risk mitigation outside of its core market. Lastly, we regard that the company has achieved a critical size pertaining to recurring EBITDA, helped by market factors and its growing outreach through the addition of new assets, which paved the way for the rating moving to the BB category.

Outlook and rating-change drivers

The Stable Outlook reflects our expectation that Greenergy's financial risk profile has stabilised, as displayed by a Scope-adjusted debt/EBITDA sustained at well below 2.5x. As flagged in the assessment of the financial risk profile the Stable Outlook incorporates the possibility that Greenergy deploys the large headroom to its internal leverage target e.g. for bolt-on acquisitions or more capex. The Stable Outlook also reflects our assumption that the credit quality of KÉSZ group remains broadly unchanged.

A positive rating action is deemed remote. Such an action would require an improved business risk profile as signalled by a significantly improved diversity of the operating business and a significant addition of energy generation and storage assets.

A negative rating action could be triggered by a sustained deterioration of the company's financial risk profile, e.g. through Scope-adjusted debt/EBITDA increasing to around 3.5x. Such an increase would reduce the headroom to financial covenants. In addition, the rating could come under pressure if the credit rating of KÉSZ group was at risk to deteriorate significantly.

Rating history

Date	Rating action	Issuer rating & Outlook
20 Sep 2023	Upgrade	BB/Stable
31 Mar 2023	Under-review placement	B+/UR for a possible upgrade
17 Jun 2022	Outlook change	B+/Positive
15 Jun 2021	New	B+/Stable

Ratings & Outlook

Issuer	BB/Stable
Senior unsecured debt	BB+

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Related Methodologies and Research

General Corporate Rating Methodology; July 2022

European Utilities Rating Methodology; March 2023

ESG considerations for the credit ratings of utilities; April 2021

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Greenergy Holding Vagyonkezelő Zrt

Hungary, Utilities

Rating and rating-change drivers

Positive rating drivers	Negative rating drivers
• Power generation portfolio comprising decentralised small-scale energy generation units (heat and electricity) with sufficient granularity and significant growth trajectory related to the ramp-up of generation capacity and storage with limited execution risk • Robust business exposure to quasi-monopolistic heat generation and supply to district heating networks and reputable industrial/commercial customers under multi-year contracts • Cash flow enhancement through the company's virtual power plant and its ability to provide reserve capacity to Hungarian transmission grid operator MAVIR, including volatile renewables and peak-load eligible gas-fired power plants (ESG factor: credit-positive environmental factor) • Recurring EBITDA margin at an expected level of more than 20% and Scope-adjusted ROCE of more than 30% bolstered by continued tailwinds from energy prices for the company's power generation and addition of new assets which are margin accretive to group margin, e.g. solar, wind parks and storage facilities • Strengthened financial risk profile bolstered by strongly improved operating cash flow, leading to very low leverage and very strong debt protection • Limited concerns about liquidity • Operation & Maintenance and EPC exposure for own and third-party generation assets	• Very limited size, scale and outreach even when doubling energy generation capacity over the next few years • Material dependency on achievable power prices for outright electricity production (which are fairly volatile on the Hungarian power exchanges OTC/HUPX) and significant dependence of achievable EBITDA margin on non-controllable price related to gas procurement • Material potential exposure to adverse foreign exchange developments • Business exposure entirely linked to core market Hungary for the near future • Possibility that Greenergy used the headroom for its, e.g. through further increase of investments or bolt-on M&A deals

Positive rating-change drivers	Negative rating-change drivers
• Improvement of the BRP but deemed as remote	• Leverage (Scope-adjusted debt/EBITDA) reverting to around 3.5x • Significant deterioration of KÉSZ group's rating

Corporate profile

Greenergy Holding Vagyonkezelő Zrt (Greenergy) is a small Hungarian utility. It operates about two dozen small-scale power plants with a total combined capacity of about 80 MW, primarily CHP (combined heat and power) plants, across Hungary. The company's business model is supplemented by O&M (operation and maintenance) services for its own and third-party power plants, energy services and energy trading.

Greenergy is directly owned by Hungarian construction company KÉSZ Group (51%) and its two Directors Mr Dósai and Mr Dajbukát (24.5% each). We consider the rated entity as steered largely independently from its majority shareholder.

Financial overview

				Scope estimates		
Scope credit ratios	**2020**	**2021**	**2022**	**2023E**	**2024E**	**2025E**
Scope-adjusted EBITDA/interest cover	27x	26x	53x	78x	39x	28x
Scope-adjusted debt/EBITDA (netting of cash)[1]	2.2x	3.0x	1.1x	1.3x	1.0x	1.1x
Scope-adjusted debt/EBITDA (no netting of cash)	2.4x	3.0x	1.1x	1.3x	1.1x	1.2x
Scope-adjusted free operating cash flow/debt	-35%	23%	-24%	21%	-6%	13%
Liquidity	negative	>200%	>200%	>200%	>200%	>200%
Scope-adjusted EBITDA in HUF m						
EBITDA	1,106	2,789	8,383	7,021	8,538	8,104
One-offs	-	-	-	-	-	-
Other adjustments[2]	-136	64	186	146	160	176
Scope-adjusted EBITDA	**970**	**2,853**	**8,569**	**7,167**	**8,698**	**8,281**
Funds from operations in HUF m						
Scope-adjusted EBITDA	970	2,853	8,569	7,167	8,698	8,281
less: (net) cash interest paid	-36	-111	-161	-92	-223	-296
less: cash tax paid per cash flow statement	-199	-842	-1,946	-2,445	-2,918	-2,703
Other changes	-	-	-	-	-	-
Funds from operations (FFO)	**735**	**1,900**	**6,462**	**4,630**	**5,557**	**5,281**
Free operating cash flow in HUF m						
Funds from operations	735	1,900	6,462	4,630	5,557	5,281
Change in working capital	-70	-35	-3,063	698	-701	537
Non-operating cash flow	-631	681	-980	-	-	-
less: capital expenditure (net)	-760	-595	-4,682	-3,420	-5,320	-4,560
Free operating cash flow (FOCF)	**-725**	**1,951**	**-2,263**	**1,908**	**-464**	**1,258**
Net cash interest paid in HUF m						
Interest paid	36	112	407	305	295	327
Interest received	-1	-1	-247	-213	-72	-30
Other items	-	-	-	-	-	-
Net cash interest paid	**36**	**111**	**161**	**92**	**223**	**296**
Scope-adjusted debt in HUF m						
Reported gross financial debt	1,616	7,737	8,144	7,724	7,808	8,501
less: cash and cash equivalents	-282	-7,683	-5,329	-2,396	-1,017	-828
add: non-accessible cash (earmarked for investments)	-	7,683	5,329	2,396	-	-
add: contingent liabilities (75% of provisions for asset overhauls)	755	933	1,311	1,443	1,587	1,746
Scope-adjusted debt (SaD)	**2,088**	**8,670**	**9,455**	**9,166**	**8,378**	**9,419**

[1] No netting of cash considered for 2021-2023E as cash is largely earmarked for investment.
[2] Adjustments for profit/loss on derecognising fixed assets, net changes in provisions, non-cash revenue.

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Environmental, social and governance (ESG) profile[3]

Environment	Social	Governance
Resource management (e.g. raw materials consumption, carbon emissions, fuel efficiency)	Labour management	Management and supervision (supervisory boards and key person risk)
Efficiencies (e.g. in production)	Health and safety (e.g. staff and customers)	Clarity and transparency (clarity, quality and timeliness of financial disclosures, ability to communicate)
Product innovation (e.g. transition costs, substitution of products and services, green buildings, clean technology, renewables)	Clients and supply chain (geographical/product diversification)	Corporate structure (complexity)
Physical risks (e.g. business/asset vulnerability, diversification)	Regulatory and reputational risks	Stakeholder management (shareholder payouts and respect for creditor interests)

Legend

Green leaf (ESG factor: credit positive)
Red leaf (ESG factor: credit negative)
Grey leaf (ESG factor: credit neutral)

CHP capacity and virtual power plant enhances Greenergy's market position and cash flow

Our assessment of a credit-positive environmental credit risk driver relates to Greenergy's combined operations of CHP facilities and renewable energy power plants that are operated individually but also as a combined virtual power plant through the company's own power plant control centre. The virtual power plant is a technical and commercial solution that allows multiple small standalone power plants to enter the electricity and system services market as a single, large power plant, thereby implementing very effective, flexible and economical energy production technology. Greenergy is able to cover both base and peak demand (particularly important in Hungary as the market is chronically short of generation capacity), which strengthens its market position, broadens its cash flow profile, supports overall profitability and eventually its credit quality.

Credit-neutral regulatory and governance risk

Regulatory risks are credit neutral. The company is not exposed to electricity supply for residential customers for which prices are legally capped in the interest of energy affordability. Moreover, the company's overall cash flow is not significantly exposed to regulated income from renewable energy generation capacities, which could be affected by adverse regulation. Governance factors are not expected to negatively affect Greenergy's creditworthiness.

No overly green carbon footprint (yet)

Greenergy's core business is largely based on energy generation from CHP power plants (modern Jenbacher technology which is overhauled frequently). While such power plants have the advantage of efficiency by combining heat generation and electricity generation (supporting cash flow generation through two revenue streams from one production process) and are classified as a sustainable energy source under the EU taxonomy, their carbon footprint is not overly favourable.

Greenergy's carbon footprint in electricity generation was slightly higher than European average (~250 gCO2e/kWh) by YE 2022, but is expected to improve significantly over the

[3] These evaluations are not mutually exclusive or exhaustive as ESG factors may overlap and evolve over time. We only consider ESG factors that are credit-relevant, i.e. those that have a discernible, material impact on the rated entity's cash flow and, by extension, its credit quality.

next few years in light of the company's envisioned growth trajectory for its renewable energy fleet. Renewable energy capacity is expected to double over the medium term from providing roughly 20% of the utility's generation portfolio at YE 2022 to about 38% at YE 2026 (see Figure 2). As such, the company's carbon footprint will likely support a stronger assessment over the medium term, but as there will not be a significant change in the near future, credit support is yet limited. Overall, this leads to a credit-neutral assessment pertaining to resource management compared to utilities for which we have flagged the exposure to clean energy production as a positive ESG rating factor.

Business risk profile: BB-

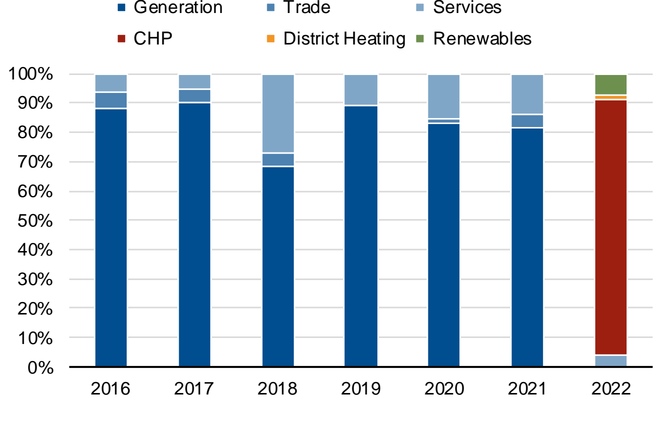
Business risk profile supported by solid business proposition related to CHP

Greenergy's cash flow and credit quality are supported by its proven position in electricity and power generation. Heat generation and supply provide stable cash flow, bolstered by local oligopolistic or even monopolistic positions, a robust and flexible tariff setting framework and medium- to long-term contracts with industrial/commercial off-takers or municipal off-takers for district heating.

Industry-inherent volatility of largely unregulated power generation

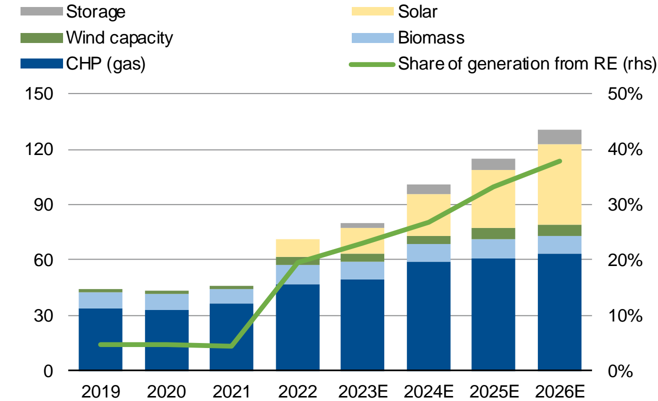
In contrast, Greenergy's exposure to electricity generation and supply, which provides about 50% of the company's cash flow, is subject to industry-inherent volatility related to merchant risks (see Figure 1). Such potential earnings volatility can only be partly offset by Greenergy's ability to provide balancing capacity to Hungary's transmission grid operator MAVIR via its virtual power plant. Consequently, the company's power generation fleet with a peak- and baseload-capable decentralised CHP portfolio, enhanced by renewable energy capacities, is a positive environmental ESG rating driver that supports the stability and diversity of Greenergy's business model and limits regulatory risk. Whilst the company is enjoying the high prices for energy sold to commercial and industrial clients, particularly for balancing power, the volatility in the prices could also play out equally negatively should achievable prices return to historical levels. However, we do not foresee this to happen in the next two years.

Figure 1: EBITDA split across segments



Sources: Greenergy, Scope

Figure 2: Portfolio ramp-up (MW) and share of renewables based on capacity



Sources: Greenergy, Scope expectations

Limited scale and outreach beyond the domestic market remain rating constraints

Greenergy's rating remains held back to some extent by its limited scale and regional risk mitigation. Although we expect a steep growth trajectory, with a doubling of generation capacity in CHP and unregulated renewables to about 130 MW by 2026, supplemented by additional growth in energy storage and energy services, the company will remain small in terms of cash flow. We judge execution risks related to the capacity ramp-up and envisioned strengthening of the business services segment to be low. The integration of new greenfield and brownfield power plants should not be overly challenging, given the company's long-standing expertise in operating small-scale, decentralised CHP plants.

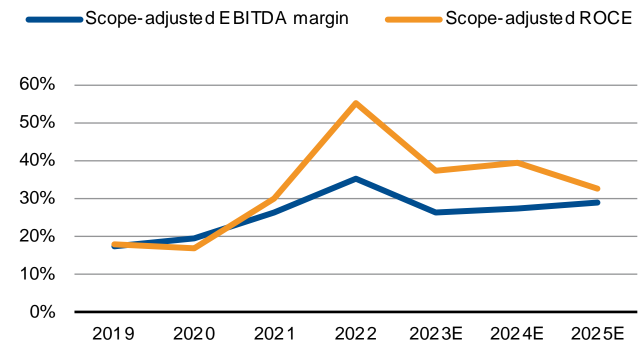
Similarly, we do not expect the integration of selective brownfield wind or solar parks to raise major concerns.

Solid profitability measures

Profitability remains a core supportive factor for Greenergy's business risk assessment. We acknowledge that margin improvements – referring to the Scope-adjusted EBITDA margin – have been bolstered by the aforementioned market tailwinds and elevated energy prices that have doubled the margin to a record of 35% in 2022 (from 17% in 2019). For the next few years, we expect the margin to reduce but remain higher than the historical average, at 25-30%. This will be driven by i) continued favourable prices in the core business; and ii) the margin-enhancing effect from newly commenced assets such as renewable energy plants and energy storage facilities. The company also performs well for our new profitability measure of Scope-adjusted ROCE, with levels of reliably above 30%, benefitting from the double income on Greenergy's CHP plants, which are depreciated to a large extent.

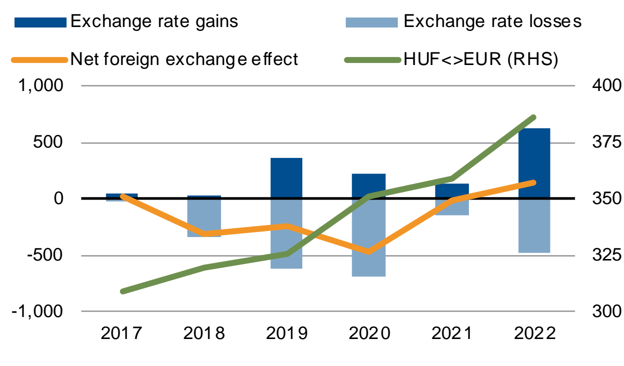
Still, material cash flow risk arises from potential adverse forex effects and a non-controllable pricing environment for gas procurement.

Figure 3: Scope-adjusted profitability metrics



Sources: Greenergy, Scope estimates

Figure 4: Significant net foreign exchange losses following persistent HUF depreciation (HUF m)



Sources: Greenergy, ECB, Scope

Eased concerns about gas flow interruptions

Concerns about reduced or stopped gas flows from Russia to Hungary have eased. Greenergy's business model in power generation and supply, however, remains vulnerable to gas flows and sufficiently filled gas storage inventories in Hungary, as more than 80% of Hungary's gas comes from Russia. We believe that Greenergy's position would be partially protected should gas flows become threatened given the utility's exposure to district heating (more than 60% of CHP plants contracted for municipal district heating or providing energy to hospitals) and grid balancing which puts it into a favourable position should gas flows be rationed.

Financial risk profile: BBB+

Consistently improved financial profile

Greenergy's issuer rating largely benefits from the financial risk profile improving to BBB+ from BBB-. While elevated energy prices in Hungary strengthened credit metrics over the past two years, primarily through higher prices for electricity and balancing capacity, the company's investments, mostly to increase energy generation capacities, are also gradually supporting solid credit metrics. We expect energy prices to normalise in the next few years but remain above the historical average. This will cause earnings in the utility's core business to shrink but still at levels close to the record high reached in FY 2022 of HUF 8.4bn, further supported by EBITDA contributed by new power generation assets. We also expect the utility's overall absolute indebtedness to remain broadly constant over the next few years, with Scope-adjusted debt at HUF 8bn-10bn,

which assumes that the increased capex of more than HUF 15bn will be funded mostly by operating cash flow and the significant cash buffer.

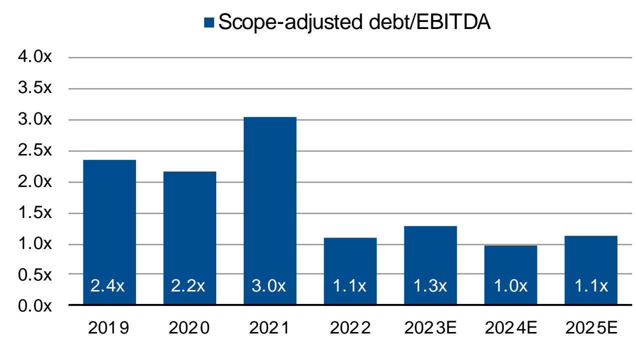
Currently very low leverage but increased leverage could be tolerated

This will likely support a sustained leverage – as defined by Scope-adjusted debt/EBITDA – within a range of 1.0-1.5x. Still, leverage could weaken if Greenergy were to use the headroom on its internal leverage threshold (net debt/EBITDA of less than 2.5x), for example, by spending more on growth investments that cannot amortise fast enough or on bolt-on M&A.

Very strong debt protection

The utility's financial strength is supported by very strong debt protection as measured by Scope-adjusted EBITDA/interest. We expect interest coverage to remain very robust at above 20x even in the absence of major cash-interest income from its cash buffer beyond 2023.

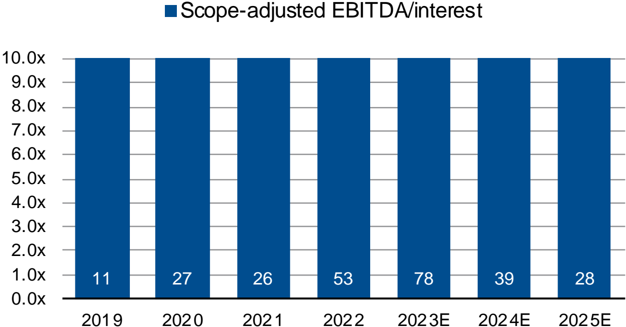
Figure 5: Expected development of Scope-adjusted leverage



No cash netting for FYs 2021-2023E when available cash was/is largely earmarked for capex

Sources: Greenergy, Scope estimates

Figure 6: Expected development of debt protection

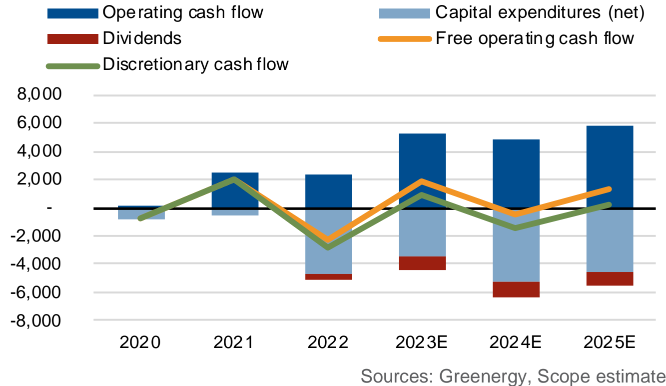


Sources: Greenergy, Scope estimates

FOCF expected to widely cover capex, but to remain volatile

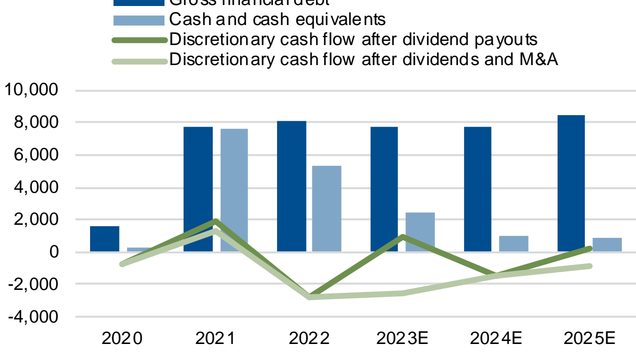
FOCF and internal financing capacity will remain strongly dependent on Greenergy's flexible investment budget. While Greenergy is likely able to internally fund all or almost all capex going forward, in line with its declared plan, we still forecast FOCF to remain volatile, fluctuating between negative and positive.

Figure 7: Investment phase and dividend payouts buffered by solid operating cash flow (in HUF m) …



Sources: Greenergy, Scope estimates

Figure 8: … also leaving gross indebtedness broadly unchanged due to solid cash buffer (HUF m) which could still be burdened by M&A activities

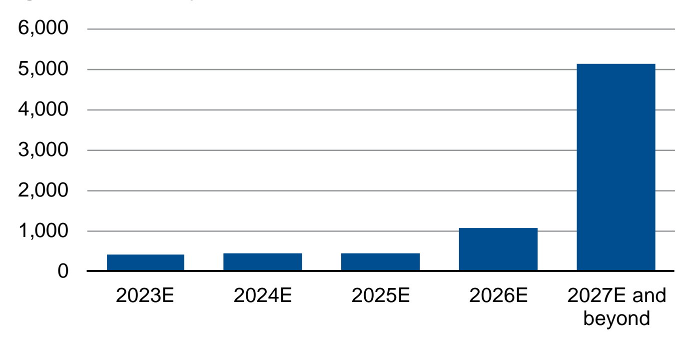


Sources: Greenergy, Scope estimates

Adequate liquidity

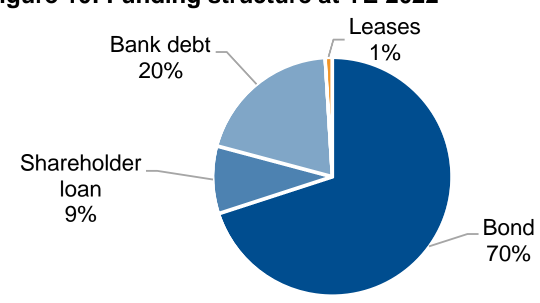
Liquidity is expected to remain adequate over the next few years as signalled by strong liquidity ratios of above 200%. Debt repayments of around HUF 500m a year for bank debt and shareholder loans are scheduled for 2023 until 2025. Such amounts as well as envisaged capex are expected to be comfortably covered by available cash sources such as operating cash flow and the significant cash buffer of HUF 5.3bn at YE 2022.

Figure 9: Maturity schedule at YE 2022 (HUF m)



Sources: Greenergy, Scope expectations

Figure 10: Funding structure at YE 2022



Sources: Greenergy, Scope

Adequate access to funding, considering small corporate size

Despite its small size, Greenergy has sufficient and reliable access to external financing though well-established relationships with Hungarian banks such as MKB and CIB. While the operating business is expected to cover the increased refinancing from 2026 (about HUF 580m of bond amortisation on top of the annual refinancing of bank loans), we think the company will develop a fallback for refinancing by issuing debt, backed by its business model and largely unencumbered assets.

Balance in HUF m	2022	2023E	2024E	2025E
Unrestricted cash (t-1)	7,683	5,329	2,396	1,017
Open committed credit lines (t-1)	-	-	-	-
FOCF (t)	-2,263	1,908	-464	1,258
Short-term debt (t-1)	267	420	448	447
Coverage	**>200%**	**>200%**	**>200%**	**>200%**

Full covenant compliance expected over the foreseeable future

The bond issued in 2021 under the Hungarian central bank's programme contains two covenants that could affect liquidity: 1) Bond repayment is accelerated if the debt rating pertaining to the bond stood below B+ for more than two years or if the debt rating dropped below B-. The headroom to this covenant is large and was even widened by the rating upgrade. 2) Greenergy has a financial covenant that involves immediate bond repayment if the consolidated leverage – defined as [debt-cash]/EBITDA – exceeds 4.0x. Based on our forecasts, there is also solid headroom to this covenant going forward even if the ratio – as forecasted – deteriorates beyond the achieved ratio from 2021 and 2022 (1.6x and 1.2x respectively).

Supplementary rating drivers: +/- 0 notches

No rating cap pertaining to lower rated ultimate parent company

Greenergy remains rated on a standalone basis. This is because the rated entity operates largely independently of its majority shareholder, Hungarian construction company KÉSZ group, which owns 51% (the remaining 49% by two of the three managing directors). We acknowledge the ratings differential between Greenergy's upgraded issuer rating of BB and the BB- issuer rating of KÉSZ group. Nonetheless, Greenergy's operational and financial independence means the issuer's rating is not explicitly capped by that of its ultimate parent.

No negative rating adjustment any longer for peer context

We have eliminated the negative one-notch adjustment for the company's limited size and outreach compared to other entities rated in the BB category. This is because the company has achieved a critical size pertaining to its recurring EBITDA, which reached more than HUF 4.0bn (around EUR 10m), backed by market tailwinds and the company's constant investment in new cash-generating assets. As such, we deem the negative ratings adjustment for peer group context that kept the rating below the BB category in previous years as being obsolete.

No adjustments for financial policy

Greenergy's financial policy is fully reflected in our assessment of the company's financial risk profile, thereby not requiring any additional rating adjustment. This is largely related to our view that the company could use the headroom it has on its leverage that could lead to a higher leverage than forecasted.

Other elements of the company's financial policy are deemed credit-neutral, neither weakening nor strengthening the company's credit profile.

- The company's strategy shows a strong growth trajectory that is likely be executed through acquisitions of single project companies with operating power generation assets. This is largely covered by cash and expected operating cash flow. Moreover, the M&A strategy bears limited execution/integration risks due to the nature of the acquisition targets and Greenergy's expertise in operating such assets.
- Following the strong operating performance but also the strong reduction of Greenergy's exposure to shareholder loans, the company has started dividend payouts. This is a substitution for the interest on shareholder loans that have been paid over the years. While the dividend payouts are well above the level of historical interest on shareholder loans, they are not overly detrimental to Greenergy's financial profile given the company's strongly improved financials and the total amount of dividends within a range of 40%-60% of the previous year's net income.

Long-term debt rating

Senior unsecured debt rating: BB+

We have upgraded the senior unsecured debt category rating along the upgrade of the underlying issuer rating. We continue to expect a robustly superior recovery for senior unsecured debt in a hypothetical default scenario, even after expected liquidation proceeds are used to cover senior secured debt and payables. Our recovery expectation is based on an expected liquidation value in a hypothetical default scenario of around HUF 18.0bn after administrative claims at YE 2025. The recovery expectations incorporate adequately high discount rates on the book values of recoverable assets. Still, the upgrade to BB+ from BB reflects our cautious stance regarding Greenergy's investment phase over the next years. As such, the debt rating will remain non-investment grade until we gain more confidence about the company's asset composition in the medium term.

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